

Tax News

February 2007

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John Chiang sworn in as new State Controller

On January 8, 2007, John Chiang was sworn in as the new State Controller, and the new chair of the Franchise Tax Board. To read his complete swearing-in speech, go to www.ftb.ca.gov and enter John Chiang in the search box.



State Controller and FTB Chair, John Chiang

20 Questions: Results of real estate withholding interested parties meeting

On December 11, 2006, we met with interested parties to discuss the new real estate withholding law (AB 2962). Interested parties included representatives from the California Land Title Association, California Association of Realtors and California Escrow Association, and members of the Franchise Tax Board Advisory Board.

Approximately 225,000 – 250,000 real estate sales transactions totaling \$2 billion occur in California each year, which are subject to withholding. Before passage of AB 2962, a flat rate of three and one-third percent was withheld, resulting in over-withholding for many taxpayers. AB2962 dealt with over-withholding by providing an alternate withholding method.

Meeting participants asked questions and offered comments. Their comments and questions are listed below, with accompanying FTB responses. To read the text in full, and to view the meeting agenda, see “Results of Real Estate Withholding (AB 2962) Interested Parties Meeting, December 11, 2006.” From our homepage (www.ftb.ca.gov), click on the “News” tab, and then “Interested Parties Meetings.” Also see “Real estate withholding – compute your estimated gain or loss online” in this issue of **Tax News**.

AB 2962 questions, answers, and suggestions

1. What should sellers do if they don't have computers?

Sellers can submit hard copies.

2. Is the booklet with 593-C and 593-E available online?

The 2007 booklet is available on our Website. Search for “593 booklet.”

3. How would sellers know that they should keep the 593-E for five years?

When the form is completed online, it sends a message that the form should be retained for five years.

4. How should taxpayers calculate withholding if they make installment payments?

See the instructions on page 6 and 7 of Form 593-B.

5. Is it necessary for taxpayers to fill out Form 593-E if they already know what the gain is?

The entry on line 16, "gain on sale," is a calculable entry. We recommend that sellers complete Form 593-E for their records, in case FTB questions how they computed their withholding.

6. Do the forms or publication show a link for the online calculator?

No. We can email the link to all meeting attendees. You can also access the calculator by going to our FTB Website at www.ftb.ca.gov.

7. Should 2006 forms or 2007 forms be used if escrow closes before January 1, 2007 but the forms aren't submitted until after January 1, 2007?

Use 2006 forms when escrow closes in 2006, and 2007 forms when escrow closes in 2007. Using the wrong year form (i.e. using a form for a year that is not the same as the year entered in box 2 of Form 593-B) may cause a delay in processing the credit.

8. Can our seller/clients sign both the 2006 and 2007 forms if we are unsure if they will close in December 2006 or January 2007?

Yes, if the seller is comfortable with signing both forms, and if you return the signed, unused form to the seller.

9. Where should we report withholding for pass-through entities?

The S corporation uses the credit for its share of taxes and then the remainder is passed through to the shareholders and reported on the K-1. The S corporation needs to file Form 592-B for each shareholder to allocate the credit to the shareholders. The real estate escrow person is responsible only for withholding on the S corporation as an entity, not for withholding on the individual S corporation shareholders.

10. Can FTB add an instruction to page 2 of Form 593-C and 593-E instructions, saying that 593-E should be retained by the seller for five years for their records?

We will do this on a going-forward basis. We won't be able to make this change to current hard copy forms, because the forms have already gone to press.

11. The forms are inconsistent in their references to withholding agents, escrow officers, and preparers. Can FTB ensure that the forms are consistent? For example, there are several cases where it should say withholding agent instead of escrow officer, including:

- Form 593-C, Part 3, above item 10.
- Page 6, under line 5.
- Page 6, under the second note under line 7.

Participants also made the following forms suggestion:

- Remove the extra decimal point on Form 593-E.
- Line 12 – Installment sale – is not normal practice. Recommend: determine if this is administrative or statutory language. Possibly remove the word “normally.”
- The bold language on Form 593-E is great, but bigger and bolder would be even better.

Box 6 instructs the seller to complete Boxes 8 and 9 only if the seller chooses the alternative election. Because the instructions are very small, sellers might mistakenly complete Boxes 8 and 9 when they choose to withhold three and one-third percent.

We will examine the forms and, where possible, will make corrections and update the online versions of the forms. The current hard copy forms will not reflect the changes, however.

12. The forms require a lot of information, and sellers don't always read the instructions. 593-B is confusing for the seller because it requires a signature under Part 2 of the form if they are electing the alternative withholding rate, but the seller should not sign there if they are choosing the three and one-third percent withholding rate. What should the escrow or withholding agent do if this happens?

They should send in the form anyway. The calculation on the form will show which rate sellers choose.

13. What should the withholding agent do if escrow closes, and there is no signature on the form even though the seller chose the 9.3 percent rate on the gain? The instructions on the form say that the three and one-third percent rate will be applied if there is no signature.

Escrow can make the correction as long as everything is done correctly when it is submitted to FTB. We will follow up on this.

14. Will withholding agents be penalized if the seller makes mistakes that the withholding agent is unaware of?

The penalties are not in place for unintentional mistakes. As long as withholding agents provide the information to the best of their knowledge, penalties will not be charged.

15. What is the determination for issuing penalties?

Penalties are focused on extraordinary situations and flagrant violators.

16. Who gets the \$50 penalty – the seller or FTB?

All penalty amounts should be sent to the FTB.

17. Is there a statutory basis for the penalty? And, how does the state know if the withholding agent gave the appropriate form(s) to the seller?

Yes, there is a statutory penalty for late payments.

The state can determine if the appropriate forms were provided to the seller during an audit, when FTB requests the documents that were given to the seller by the withholding agent.

18. The following language from FTB 677, *Information for Sellers and Buyers*, might be misleading, and the buyer may presume that withholding will be done by the escrow officer:

“...as part of the escrow services, the escrow officer generally assumes the responsibility for withholding or documenting why no withholding was done and for sending payment to the Franchise Tax Board.”

Can FTB fix this?

We will take note of this, and rethink the language for our next update.

19. Although signatures are not supposed to be faxed, what happens if they are faxed?

We will follow up on this question.

20. Language in AB 2962 states that escrow officers accept and submit information in good faith. An escrow officer is not supposed to know the seller's gain. Is the Withholding Agent liable for incorrect information given to them by the seller?

This language in AB 2962 was designed to address blatant wrongdoing.

Meeting participants also offered these suggestions:

- FTB should revise the 593-B to require a signature from the seller whether they choose the three and one-third percent, or 9.3 percent rate.
- Revise Part 2 language to stand out more.
- If the seller elects three and one-third percent, include a note that says, "Do not sign below."
- Have the seller initial next to the three and one-third percent rate if the seller chooses this rate.
- Enlarge Box 6.

We appreciate these comments and suggestions, and will consider them all.

Real estate withholding – compute your estimated gain or loss online

Need some quick help calculating the correct amount to withhold on real estate transactions? Our online Form 593-E, *Real Estate Withholding – Computation of Estimated Gain or Loss*, will calculate the correct withholding for you.

AB 2962, signed into law on September 22, 2006, changes real estate withholding requirements for all transactions closing on or after January 1, 2007 (see November **Tax News**. Sellers now have a choice:

- Withhold three and one-third percent of the property's sale price.

OR

- Elect an alternative withholding amount based on applying the maximum tax rate to the estimated gain.

Sellers can calculate the estimated gain or loss on the sale using Form 593-E, *Real Estate Withholding – Computation of Estimated Gain or Loss* by entering information like selling price, expenses, and depreciation. The form will calculate the estimated gain or loss, the standard withholding amount, **and** the alternative withholding amount.

You can find this form on our Website at www.ftb.ca.gov, by searching for "593-E."

2007 Franchise Tax Board Information Directory now available

When you need a phone number or Web, email, or location address, refer to our new, 2007 FTB Information Directory. This compact online listing contains a wealth of FTB contact information. Find the directory on our Website by entering "directory" in the search box.

Paying electronically saves your clients time

Your clients can take care of their FTB financial responsibilities electronically, and have the peace of mind that FTB securely received their payment. Paying electronically means your client doesn't have to spend time writing and mailing a check, and their payment is quickly applied to their account. The various ways your clients can pay electronically are described below.

Electronic funds withdrawal: This is the option to pay electronically when e-filing. Your client can pay when they e-file their balance due return, and not worry about having to remember to mail a check. They can choose the amount they want to pay, as well as the date they want the funds to be transferred from either their checking or savings account. Your clients can even schedule electronic withdrawal for their next year's estimated tax payments when they e-file.

Web Pay: Your clients can request a debit to their account online, at any time, to pay **any** FTB liability, including:

- A balance due on their current-year tax return.
- Extension payments (Form FTB 3519).
- Estimated tax payments (Form 540-ES).
- Prior-year amounts.
- Any bill.

Similar to direct debit, your clients choose the amount to pay, and the date the funds should be transferred from their checking or savings accounts.

To use Web Pay, all your clients need is their Social Security Number, and FTB customer service number (enter "CSN" in the search box).

Credit Card: Your clients can use their credit cards to pay **any** bill when they make a payment through Official Payments Corporation. Official Payments Corporation charges a convenience fee of 2.5 percent (minimum \$1), and accepts the following cards:

- Discover/NOVUS
- MasterCard
- Visa
- American Express

If your clients are unable to pay their balances in full, encourage them to apply for an installment agreement online (enter "installment agreement" in the search box). Generally, your clients will qualify if they:

- Owe a balance of \$10,000 or less.
- Agree to pay their balance in 36 months or less.

- Have filed all personal income tax returns.

Online installment agreements are available for balances of \$10,000 or less. FTB also accepts installment agreement applications for balances up to \$25,000, and for payment periods up to 60 months. However, taxpayers who owe balances between \$10,000 and \$25,000 should call FTB at (800) 689-4776, to discuss setting up an installment agreement.

FTB's filing enforcement program in full swing

In January's issue, we reported on the kickoff of our 2007 filing enforcement program for the 2005 tax year (**Tax News**: "Nonfiler notices mailed in December"). In late December we mailed the first 80,000 of approximately 800,000 *Request, or Demand for Tax Return* notices to persons we believe should have filed personal income tax returns for tax year 2005. The notices are based on information reported to FTB by many sources. See the January article for a partial listing of sources. We will continue mailing the remainder of the *Request, or Demand for Tax Return* notices through May 2007.

If you have clients who received a *Request* or *Demand* notice from us, urge them to respond soon. On March 5, we will begin mailing a *Notice of Proposed Assessment* (NPA) to the individuals who do not respond to the initial notice, or do not demonstrate to us that they are not required to file.

NPA projected mailing dates and volumes for the 2005 tax year:

<u>Mail dates</u>	<u>Volumes</u>
03/05/07	48,000
03/19/07	60,000
04/02/07	60,000
04/09/07	60,000
04/16/07	51,600
04/23/07	54,000
04/30/07	24,000
05/14/07	36,000
07/23/07	30,000

The quickest way to respond

Many of your clients' return filing issues can be resolved immediately via the Internet, or by calling our Interactive Voice Response (IVR) system at **(866) 204-7902**. These options are available seven days a week, 24 hours a day for your convenience.

Visit our secure Website at www.ftb.ca.gov/inc, and review the available services.

After entering the Website, type in the unique notice number located above your client's name and address on the notice. A menu will be displayed, from which you can:

- Request additional time to respond to the notice.
- Close the case if your client filed under a social security number different than the one we have on file.
- Close the case if your client does not have a filing requirement (you will be prompted to answer some questions). This feature is used for situations such as:
 - o Your client was a nonresident, but filed a federal return with a California address for the tax year in question.
 - o Your client held an active California occupational license or city business tax license, but did not do business during the tax year.

Contact us

Email: Use the secure email feature on our Website to ask questions or provide information to us. Our secure email address is Filing.Enforcement@ftb.ca.gov.

Write or fax: If you prefer to respond to our notices in writing or by sending a fax, you will find instructions for these options printed on the notices.

We would love to hear from you

We realize that our annual filing enforcement process can greatly affect the tax preparer community. If you have any suggestions for improvements, please contact Kurt Vickner at kurt.vickner@ftb.ca.gov with your suggestions and ideas.

Inside FTB

California follows new IRS deadline of April 17

California taxpayers will get an extra two days to file and pay their 2006 state income taxes. On January 24, the Internal Revenue Service announced the new April 17, 2007, deadline, and FTB quickly changed the California deadline to mirror the federal action.

The April 17 deadline applies to:

- 2006 State and federal income tax returns, whether filed electronically or on paper.
- 2006 Balance due tax payments, whether made electronically (e-Pay, credit cards) or by check.
- Individual estimated tax payments for the first quarter of 2007, made electronically or by check.
- Other provisions as detailed by the IRS in their news release [IR-2007-15](#).

All California taxpayers get an automatic six-month extension to file their state tax return, although payment is due by the new April deadline. The FTB receives more than 15 million state income tax returns annually.

We want your tax gap ideas!

You've seen many articles about the tax gap on our Website and in **Tax News**, expressing our strong commitment to closing the gap. Many experienced and creative people are looking at how we can achieve this goal.

You may also have great ideas about how to close the tax gap, and we would like to hear them. Getting your feedback is an important strategy for us. We have included it in several areas of our Tax Gap Plan, which you can find on our Website (enter "Tax Gap Plan" in the search box) – see "Critical Success Factors (page 14) and Appendix One (page 16), Goals One and Six. We've established a "virtual suggestion box" so that you can submit your ideas and suggestions online, anonymously if you prefer. To get to our Tax Gap Suggestions Webpage, go to our Website at www.ftb.ca.gov and enter "tax gap suggestions" in the search box. Let us hear from you!

Tax News survey results

Over 1,100 **Tax News** subscribers responded to our December survey, and gave us invaluable feedback. Almost a quarter of you who took the survey spent a little extra time and gave us your comments. Here's a breakdown of answers to each question.

Distribution of responses to individual questions:

1. Does Tax News cover issues that are important to you?

	Number	Percentage
Always	170	15
Usually	740	66
Sometimes	207	18
Never	4	0

2. Does Tax News give you information you can use in your job?

	Number	Percentage
Always	265	23
Usually	594	52
Sometimes	256	22
Never	6	0

3. Does Tax News publish timely information?

	Number	Percentage
Always	355	3
Usually	662	59
Sometimes	100	8
Never	4	0

**4. Should Tax News include more articles about any of the following programs?
Check all that apply.**

	Number	Percentage
Collections	427	15
Audit	627	23
Filing	718	26
Criminal activity	264	9
Legal/legislation	608	22
Fill-in	79	2

(1026 responses: 95 skipped, 91percent responding)

5. Overall, how would you rate Tax News as a publication for tax professionals?

	Number	Percentage
Excellent	402	35
Good	584	52
Satisfactory	110	9
Poor	21	1

Question 6 was an open-ended question: "Please suggest how we can improve Tax News." We received a total of 223 comments and suggestions, in responses to Question 6, and the fill-in portion of Question 4.

Although each question offered great feedback, Question 6 gave respondents a chance to speak up about anything that was not covered on the survey. Responses can be organized under four main categories: content, format, publication schedule, and general approval or disapproval.

You may view all of the Survey comments exactly as they were submitted, typos and all, at www.ftb.ca.gov. Search for "Tax News Survey." Suggestions and comments in the content and format categories are divided into sub-categories:

Content

- State/Federal conformity
- Practitioner needs
- Tax law and legislation
- Tax programs
- Filing and forms

Format

- PDF version of **Tax News**
- Return to the printed publication
- Article length
- Search/indexing
- General layout

Thanks again for your participation in the survey. And, if you have new ideas or additional comments, drop us an email at taxnews@ftb.ca.gov.

Criminal Corner

We are committed to closing California's \$6.5 billion tax gap, defined as the difference between tax that is owed and tax that is paid. Our special agents work cooperatively with law enforcement agencies throughout California to uncover illegal behaviors that contribute to the tax gap. These include underreporting income, overstating deductions, failing to file returns, failing to pay taxes due, and making illegal cash payments to employees.

Tax fraud is not a victimless crime. You can report suspected tax fraud by calling FTB at (800) 540-3453.

Orthopedic surgeon arrested on tax evasion charges

A Modesto doctor was arrested on January 9, 2007, by FTB special agents on felony charges of tax evasion for failure to file state income tax returns.

Thomas Kaschak, 48, a self-employed orthopedic surgeon, also writes medical software under Consolidated Practice Management, Inc. Kaschak was arrested without incident at his Modesto home. According to FTB special agents, Kaschak allegedly failed to file his 2000-2004 state income tax returns. He earned more than \$1.6 million during these years and owes nearly \$138,000 in unpaid tax.

Each felony tax count carries a maximum term of three years in state prison. FTB agents seized financial documents related to the business operations, which will point to underreported income. Kaschak claims to be a non-resident of California, with a residence in Reno, Nevada. Investigators allege that he has performed more than 1,100 procedures at Memorial Hospital in Modesto since 1996, and has been issued Form 1099s reporting the income.

Kaschak was booked into the men's jail in Modesto, with bail set at \$250,000.

Alleged con artist couple faces 14 felony charges

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A Danville couple face more than one dozen felony charges after an investigation led by the Contractors State License Board (CSLB), in cooperation with the FTB, and Contra Costa County District Attorney's Office.

Rick Alvin Powers and Cathy Powers are accused of bilking ten consumers out of more than \$100,000. The two were arrested January 12, 2007, when they arrived at their office in Danville. They now face grand theft, elder financial abuse, and charges of failing to file income tax returns. Both are being held in the Contra Costa County Jail. Rick Powers is being held on \$500,000 bail.

The charges stem from eight formal consumer complaints to the CSLB that the couple would take huge down payments (as much as 62 percent) for high-end cabinets, then do little or no work at all. They would then con the consumers into believing the cabinets were about to be finished, but additional money would be needed. It's alleged that they also failed to pay suppliers, other vendors, employees, and taxes. Both Rick and Cathy Powers have had a long complaint history with the CSLB, and with the California legal system for violations of contractor's license law, including receiving excessive down payments. Rick Powers has had two contractor licenses (#602480 & #309421) revoked. Cathy Powers has had one contractor license (#723398) revoked. Their criminal convictions include diversion of funds, burglary, and insurance fraud.

Due to the license revocations and convictions, the couple is prohibited from having a contractor's license or acting as an officer, director, associate, partner, or qualifying individual of a licensed contractor.

Before hiring any contractor, homeowners should go online at www.cslb.ca.gov or call CSLB's automated phone system 1-800-321-CSLB (2752) to verify that the contractor holds a valid license, has workers' compensation and liability insurance, and to check out their complaint history.

The FTB played a critical role in the investigation. Their work led to three of the felony charges, for allegedly failing to file their personal state income tax returns in 2001, 2002, and 2003. They earned more than \$580,000 in taxable income during this period.

The CSLB's investigation into this case continues. Philip Leech, the licensed contractor who associated with the Powers may face charges. There may also be additional victims who are encouraged to contact CSLB to file complaints.

The Contractors State License Board operates under the umbrella of the California Department of Consumer Affairs. The CSLB licenses and regulates California's 305,000 contractors, and investigates more than 20,000 complaints against contractors annually. In fiscal year 2004-05, the CSLB helped consumers get more than \$36 million in restitution.

The buzz on big business**Federal and state audit activity**

To achieve our audit goal of determining the correct amount of tax, we may look at federal issues (where California conforms to federal law), and issues that only apply for California purposes. Our audit strategy is to open an audit on a tax return as soon as we possibly can after the return is filed, and to finish that audit as quickly and efficiently as we can. This is sometimes easier said than done when we are auditing the larger corporate taxpayers, especially when an IRS audit is underway at the same time.

If both the FTB and the IRS are auditing your return, or your client's return, our goal is to complement the IRS activity and eliminate any IRS or FTB duplication of effort. When the IRS is reviewing an issue, or has made a determination on an issue, FTB will generally await the final federal determination of that issue. In the situation where the IRS is auditing your or your client's return, and we identify a federal issue of concern that the IRS is not looking at, we may request documentation on that issue to determine the correct amount of tax.

Throughout the audit process, our goal is to avoid duplication of effort. If we pursue an issue that you or your client knows the IRS is auditing, please don't hesitate to tell us. The IRS issues Information Document Requests (IDR) for information, just as we do. The best way to demonstrate that the IRS is auditing an issue is to provide us with a copy of the Revenue Agent or International Examiner's IDR, showing that the subject of the IDR is the same issue in question.